What We Could Have Learned from the New Deal in Dealing with the Recent Global Recession

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Jan Kregel, Levy Economics Institute of Bard College

Abstract

The Great Depression of the 1930s was followed by a series of regulatory and policy decisions that laid the groundwork for a twenty-year post-war expansion with stable prices and stable financial markets. The recent crisis has also been characterized by regulatory and policy decisions aimed at isolating government from responsibility for financial instability and increasing the role of the Federal Reserve in regulatory and supervisory matters. While financial markets have recovered, they remain highly volatile, and the recovery in real activity has been feeble. Are governments, politicians and economists less able to draw the appropriate lessons from the recent crisis than they were in the 1930s?

Prefatory Remark:

When Giuseppe Fontana suggested that I speak on the theme of Lessons for Our Grandchildren From the Current Crisis my initial response was that it would be too short for a keynote event, as my answer would have been a simple: “Nothing at all – indeed, we even forgot the Lessons of the 1930s.” We then agreed on a revised thematic: Lessons that we forgot from the Great Depression of the 1930s. I must thus apologise for returning to the well-worn terrain of the dissection of the New Deal, and more recents attempts to relate it to the current crisis (see for example Desai, 2011, or Shugart, 2011). My scope is rather on highlighting the way in which Roosevelt went about the process of getting the public “substantially united in favor of planning the broad objectives of civilization” and then how “true leadership must unite thought behind definite methods on how we identify our objectives.”

Introduction

In every period of crisis, it is common to refer to the two Chinese characters comprising the word "crisis", one representing “danger” and the other, “opportunity”. I am told that this is a misrepresentation of the second character of the ideogram, ji (机）which should be better rendered as “critical point”. This seems to indicate a potential for both a positive and negative outcome.

With reference to the 1933 banking crisis Walter Winchell noted that “Every crisis breaks a deadlock and sets events in motion. A bad crisis is one in which no one has the power to make good use of the opportunity, and, therefore, it ends in disaster. A good crisis is one in which the power and the will to seize the opportunity are in being. Out of such crisis come solutions.” He considered the banking crisis of 1933 as a “good’ crisis.

To provide the ligature to the present note that the now embattled mayor of a major mid-western city, offered a similar opinion in the midst of the more recent Great Recession: “never let a serious crisis go to waste. … it's an opportunity to do things you think you could not do before.”

Thus the question is whether the response to the present crisis “did things that could not be done before” in the same way as in the New Deal response to the Great Depression. With respect to the latter point, nearly a decade has passed since the most recent “critical point” and as yet there is no convergence of opinion on whether this was a good crisis or a bad crisis.

Two Critical Points

The similarities between the “critical points” of the more recent Great Recession and the earlier Great Depression are chilling, as are the differences in the policy responses. The most obvious similarity is the central role of the collapse of the banking and financial system in both crises and the measures taken to overcome the critical conditions in the financial sector. But, as will be argued below, this similarity is deceptive and leads to an undue emphasis on the proximate cause of the collapse in economic activity on the misbehavior of the financial system and the belief that by fixing the financial system the rest of the economy would come back into line.

The March 1933 Bank Holiday that ushered in the newly elected Roosevelt Administration came over three years after the September 1929 stock market break and a period of futile policies measures to counter the rising tide of unemployment and bank failures as national income fell by almost a half. After the exuberance of the roaring ‘twenties post war recovery, the stock market break and then the failure to provide recovery leading to the banking crisis created an aura of increasing helplessness and desperation, a final collapse that suggested the failure of a liberal democratic solution. Veterans marching on the White House to demand their pensions in the presence of what were considered to be successful responses to the crisis by Fascist and Communist countries made the failure of traditional policies to reverse the crisis and its culmination in the national closure of banks more debilitating.

On the other hand, the recent crisis is almost the reverse of the 1930s events. it was the unforeseen and unexpected collapse of the housing and commodity market euphoria and the possibility of financial failure of long established institutions such as Citibank, AIG and Merrill Lynch that inaugurated a disintegration of financial relations and confidence that quickly sent the real economy into a self-reinforcing downward spiral without any hope of rapid recovery.

Nearly a decade after the collapse of the sub-prime loan market and the financial system, the real economy is still operating well below productive capacity at reduced growth rates that have become so pervasive as to be called the "new normal", with virtually no improvement in household incomes compared with the pre-crisis period. It is the centrality of the banking crisis and the similarity of the policies employed that blurs our vision of the other causes of the disappointing performance and thus of the lessons to be learned from the policy responses of the two periods of crisis.

Indeed, the emergency responses to the financial crisis in the present crisis more or less followed the measures taken in the prior crisis, although with important differences in degree. The existence of New Deal measures such as deposit insurance and the size of government and the associated automatic stabilisers provided by social security measures explain the absence of a classic bank run and a decline in activity and employment that was far less than in the 1930s. It was the failure of government policy to reverse the recession following the stock market collapse that acted as prelude to the Bank Holiday, while in 2008 it was a period of euphoria and the collapse of the financial system that caused the recession in output and employment. In the 1930s solving the banking crisis was a prerequisite to the promulgation of policies to deal with the continuing Depression, while in the later period solving the banking crisis had little impact in resolving the recession and appeared as being necessary and sufficient for the rapid recovery of the system. Put simply the problem to be faced in both periods was not financial, it was in responding to the debilitated forces of domestic and global demand. Thus, it is in the policy response after dealing with the financial crisis that the lessons that should have been learned were clearly ignored and forgotten. But first what were the lessons learned in the 1930s?

The New Deal Confronts the Age of Uncertainty

Ira Katz Nelson (2013) provides an insightful interpretation of Roosevelt's objective in proposing a "New Deal" to the American people. He notes that what "observers and commentators" of the dilemma facing the incoming administration "shared was an understanding that theirs was a time when uncommon uncertainty at a depth that generates fear had overtaken the degree of common risk that cannot be avoided. … when uncertainty looms, the ability to choose is transformed. … Measurable risk generates worry. Unmeasurable risk about the duration and magnitude of uncertainty spawns fear. … Under conditions of fear… people develop a heightened mindfulness and self-awareness about the constraints on free action, and take, as a central goal, the desire to restore a higher degree of coherence and uncertainty; that is, they try to reduce deep uncertainty to ordinary risk."

Roosevelt's response to the "critical point" faced by the economic and political system in 1933 was to take measures that would eliminate the deep uncertainty, what he called the "fear of fear". What had disappeared after 1929 and what was believed to be the major impediment to recovery was the loss of conditions in which "choices are made based on past experience. Because the properties of most things remain fairly constant, and because the relation between cause and effect is mostly predictable, it is possible to assess probabilities intelligently. When firms invest, when parents decide which school to select for their children, when individuals buy a house, or when political leaders bargain, vote, and make laws, most of the time the distribution of likely events from particular actions can be calculated, either intuitively or on the basis of statistical analysis. This is the basis for most strategic calculations and rational estimates based on a reasonable degree of confidence." (op. cit.: 33) These were the conditions that had to be restored if recovery were to be achieved.

In his presentation Katz Nelson refers to the description of uncertainty and risk presented in the work of Frank Knight (1921), but also provides a footnote reference to Davidson's Keynesian conception of fundamental uncertainty. This use of the contraposition of risk and uncertainty and his framing of the objective of New Deal policy probably fit more easily in Keynes's approach to uncertainty in explaining the paralyzing force that prevents the system from self-adjustment, or to Shackle's (1961) highlighting of the difference between "serial experiments" and crucial, unique decisions. But the origin of the idea's is unimportant, it is Katz Nelson's view that this was the framing of Roosevelt's interpretation of the breakdown of the system[1] and the policies that would be required to eliminate the "fear of fear itself" that pervaded the decade of the 1930s.[2]

[1] The reference to uncertainty is not novel. Economists have used uncertainty as the explanation of the collapse in output after the Stock Market Break due to the impact on investment (Bernanke), consumption (Romer. 1990) and interest rates (Ferderer and Zalewski). In this case the use of uncertainty is more of socio-systemic nature similar to Keynes observations in the Economic Consequences of the Peace about the breakdown of the implicit bargain upon which the pre-WWI system was based, leaving nothing in its place to anchor behaviour.

[2] One of the objectives of Katz Nelson's book is to show that the success of New Deal policies was dependent on legislative approval via the liberal democratic process as an alternative to authoritarian alternatives and the crucial

New Dealers believed that Hoover's policies were based on the mistaken idea that the system would eventually return to normal, when the real problems was that the breakdown of the capitalist system was reproducing conditions of fundamental uncertainty. As a result "Rexford Tugwell argued that new types of federal intervention had become necessary because the very idea of an independent and free market was no longer compelling. The jig is up. The cat is out of the bag. There is no invisible hand. There never was. If the depression has not taught us that, we are incapable of education." Washington, he announced, was "recapturing the vision of the government equipped to fight and overcome the forces of economic disintegration. A strong government with an executive amply empowered by legislative delegation," he thus concluded, "is the way out of our dilemma, and forward to the realization of a vast social and economic possibilities." (quoted in Katz Nelson, op. cit. 232)

"Seeking to reduce paralyzing national fear to more manageable risk," the New Deal "programs shaped by this activist sensibility guided industrial decisions, regulated the economy's commanding heights, organized countervailing powers for working people, and provided security for persons who fell outside labor markets for reasons of age, infirmity, or unemployment." … "the central goal of these initiatives was "to promote a more stable and more evenly distributed prosperity, and to prevent the inevitable breakdown of an undisciplined, uncoordinated control of the business enterprises upon which our security and freedom depend." (ibid).

The particular measures involved " passing new rules for banking and investing, by convening new large–scale programs to build infrastructure and advance conservation, by providing public employment, and by comprehensively enlarging labor rights and creating America's first fully modern program for social insurance, the administrators of the New Deal, forcefully rejected what the new president, at his inaugural, had called "an outworn tradition" of political economy that thought markets to be self-correcting". (ibid).

The First Step: Removing the Fear of Banks

Bank failures had been increasingly common since the late 1920s, and a national bank holiday had \been proposed by the Hoover Administration and the Federal Reserve in the presence of accumulating state bank regulators' decisions to close banks in the period between Roosevelt's election and his inauguration. (Kennedy, p. 155 note 9). Thus the first step in the elimination of fear was to restore confidence in the

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support of Southern Democrats seeking to defend slavery to produce Congressional majorities and managing of legislation in committee. It is confirming that racial equality is completely absent from New Deal policies. .

financial system. Roosevelt had virtually no training or competence in economics and “had no plan of his own for opening the banks” (Kennedy, 168). However, the reform of the financial system had been under discussion in Congress since 1930, in particular due to series of banking reform bills submitted by Carter Glass, the father of the Federal Reserve System. In addition, measures that had been under consideration by the Hoover Treasury and the Federal Reserve, were also available and could be implemented extremely rapidly.[3]

These existing proposals won out over more radical options such as the nationalization of the banks, and the issue of scrip to meet the problems that would be taken during the bank holiday closure.[4] Roosevelt himself seems to have proposed an even more radical proposal: to make all outstanding government bonds, some $21 billion, immediately convertible into cash (a real bond drop, pace Woodford and Lord Turner). As Kennedy notes, Roosevelt’s choice of orthodox experts who had developed the earlier proposals to advise the process in the end precluded these more radical proposals and the procedure taken for the restoration of confidence in the banks after their reopening was in fact the one that had already been formulated by Hoover’s outgoing Treasury Secretary Ogden Mills. Indeed, after having refused to cooperate with any of Hoover’s proposals before the inauguration, the cooperation between the officials of the two administrations was strikingly effective. Moley’s (1966: 169) first had account confirms that “the evidence shows conclusively that practically all the tools in meeting the emergency were already in existence in the Hoover Administration.”

The Mills proposal was to group banks into three categories and then reopen those in the major Reserve Cities that were Class A certified sound, in order to give the public certainty as to the payments system. The second tier Class B banks were to be opened next day, with the addition of additional capital to ensure they could be considered safe, and then at a later date, the third tier banks subject to conservatorship were either to be wound up or recapitalized and reopened.

[3] In this regard it is important to note that in addition to the role of Southern Democrats in the success of New Deal policies Thomas Ferguson (1995) emphasizes the importance of what he calls “money-driven political systems”, and especially the impact of changes in the industrial structure of the US economy and the changes in the control of the financial system leading to support for both a more open trading system and measures to support higher levels of aggregate demand to meet the needs of capital intensive and export industries for high volumes. His essay, “From Normalcy to the New Deal” notes the importance of influence of the changes in the dominant financial institutions in providing support for the formulation and rapid acceptance of the bank reforms.

[4] In the event an emergency order allowed banks to undertake ”usual banking functions to such extent as its situation shall permit and as shall be absolutely necessary to meet the needs of its community.” (Emergency Regulation No. 10, issued by Secretary Woodin on March 4, quoted in Kennedy 164).

In the current crisis there were many who lamented the failure to follow a similar procedure. But, the procedure was not as successful in restoring banks to health as it has been remembered. According to Jesse Jones, head of the Reconstruction Finance Corporation (RFC) responsible for providing the capital injections needed by weak and insolvent banks "It could easily be charged, and properly so, that a fraud was practiced on the public when the President proclaimed during the bank holiday broadcast that only sound banks would be permitted to reopen. It was not until the late spring of 1934, nearly fourteen months afterwards, that all the banks doing business could be regarded as solvent" (Jones, 29). The main reason for this was that in the days between the March 9 Emergency Banking Act and the March 13 target for reopening of sound banks "it was difficult to decide whether a bank was truly sound. The plunge in values, particularly market values, made one man's guess as good, or bad, as another's in assessing the probable worth of many a bank's portfolio. Mistakes were inevitable. A great many unsound banks were allowed to resume business. Judged by the panic prices then prevailing, four thousand of the banks which were allowed to open in the moratorium were unsound." (Jones, 21) For non-national banks outside the regulatory remit of the Treasury's Office of the Comptroller it was the responsibility of the Federal Reserve to provide "lists of banks that might be reopened, yet they had no clear information on whether and how those lists might be used. Nor did they have a specific formula for judging banks, since national and state examiners used different standards of evaluation." (Kennedy, 183) It was these state banks that were generally considered to have been the source of the banking problem[5] and this persisted after the banks were reopened. According to Walter Wyatt, "I believe that New Jersey reopened all nonmember state banks, regardless of their insolvency, and I know that many insolvent state banks were opened by state authorities all over the country, and that they had to be restored to solvency before they could be insured by the FDIC." (quoted in Moley, 1966: 176, note)

Robey (1934: 51-2) also notes that "some of the banks licensed to resume operations without restrictions were known to be insolvent unless new capital had been poured into them during the holiday. It was possible that it had been. It was not probable. … On Tuesday, with the opening of banks in some 250 other cities, almost the last basis for hoping that licenses would be granted only to solvent institutions was wrecked. It would have been impossible to raise enough capital within one week to bolster up so many weak institutions. … Thousands of banks were open that were unsound. We still did not have a solvent banking system. Even this, bad as it was, did not complete the picture. In addition, we would have

[5] "Glass put his finger on the basic situation, which had had so much to do with the creation of the crisis. This 'was the multiplicity of state banks and the lack of proper supervision of them by state authority'." (Moley, 1966: 186)

hundreds upon hundreds of millions of dollars of deposits frozen in closed [class C] banks." The inherent paradox in the Mills procedure as a means of restoring confidence according to Robey, was that it would be difficult to convince the public that the banking problem had been solved if all of these Class C banks' deposits remained uncertain. It was these banks, managed by Conservators under the Bank Conservation Act that Jesse Jones refers to in his assessment that all the banks open were not really solvent until January 1934. This flaw in the reopening procedure was a source of continued distrust in the banking system and preserved the public's general perception in the prevailing weakness of banks. Thus a policy to ensure full elimination of fear had to be met with other, longer-term policies, that dealt with the structural weakness of the banking system. One proposal was to have the sound banks absorb the weaker banks, a proposal that was roundly rejected by the bankers[6] (as was the request to banks to rescue Lehman Bros in September 2008). According to Robey it was in the panic to find alternative support for the banks that the impetus to resort to reflation of prices to improve the value of bank assets, promoted by Irving Fisher (e.g. Fisher 1934, Allen, 1977) and on the advice of George Warren (1933), the decision to devalue and then go off gold in order to raise commodity prices, was born.[7]

While the separation of deposit and investment banking is the most visible structural measure of the 1933 Bank Act, this was primarily the result of the battle for control of the financial system (Ferguson, op. cit. 148-9). there were two more important confidence building measures. On March 9, the RFC had been authorized to invest in the preferred stock or capital notes of commercial banks. According to Jones "This program of putting capital into banks prevented the failure of our whole credit system. (26) However, he also notes that "Getting the banks to cooperate in the preferred stock program was unexpectedly difficult. … bankers, in general remained reluctant to ask the government for our help."

The second was the decision, over the objections of the President, Senator Glass, Professor Willis and others, to accept Congressman Steagall's proposal for a deposit guarantee system in the March Banking Act on a temporary basis to commence on the 1st of January 1934. Aside from the confidence generated

[6] Jones recounts a visit he made to J.P. Morgan (Jones, 23) to solicit him to organise New York bankers members of the New York Clearing House to recapitalize the Harriman Bank and Trust Company to avoid its being placed in Class C conservatorship (the only New York bank thus classified). He was met with polite refusal.

[7] One of the most controversial, and least effective actions which is perhaps best explained by Robey charge of panic. Beard and Smith (op. cit. 111 ff) note that the Agricultural Adjustment Act already provided extensive posers to the President to influence exchange rates through the Federal Reserve. Eccles notes the major fallacy of the argument that it would increase purchasing power in the fact that few people held gold and certainly few of the unemployed. (Eccles, 123). However, Moley, (1966:300) links the decision to the response to the Thomas Amendment to the farm bill to remonetize silver or to issue greenbacks to set the price of gold, which he eventually accepted.

by the guarantee, the deadline for banks' qualification for insurance provided the impetus to the banks to accept the RFC capital injections. As Jones notes, by mid-December there were some two thousand banks that could not meet the capital requirements for membership in the deposit guarantee scheme, all of whom recognized that after the initiation of the scheme on January 1 they would be at a distinct disadvantage relative to member banks who did qualify. Banks were thus classified as solvent on condition that they accept the capital injection from the RFC in the form of sale of preferred shares, and thus qualify for deposit insurance.

Thus, as already noted, Roosevelt had no clear operational ideas on how best to deal with the banking crisis, and in the end opted for a plan that had already been elaborated by members of the previous administration, and subsequently supported measures that had been widely ventilated in Congress, including deposit insurance which he initially rejected. But, he was clear that the particulars of the proposals or their impact on the condition of the banks' balance sheets was not the most important objective, it was the confidence of depositors and their ability to rely on the financial system. In the famous fireside chat there is implicit reference to the fact that the problem could be resolved if only the public would have faith in the system, to stop fearing fear so that the run could be reversed. Both Raymond Moley and Secretary Woodin "were convinced that the key to reviving the banking system was restoring the public's faith in banking…. To reassure depositors, Moley and Woodin wanted Roosevelt to make a direct appeal to the public to put their faith in the banks." (Cohen, 2009: 77) "We know hos much of banking dcepended upon make-believe or, stayed conservatively, the vital part that public confifence had in assuring solvency. … It was essential to public confidence and the termination of panic that as many banks as possible be reopened at the end of the holiday. Where there was doubt about solvency, the decision should be weighted on the side of reopening," (Moley, 1966: 171-2) Mark-to-market accounting would not have been compatible with this approach to the crisis!

An Orthodox Detour to Certainty

However, the first order of business in the search to build the confidence of the public after the banking act was an Economy Act: "A Bill to Maintain the Credit of the United States", drafted by fiscal conservative Budget Director Lewis Douglas, to meet the Democratic platform pledge to cut government spending by 25 per cent and according to Roosevelt's top advisers to restore business confidence. "Roosevelt liked to think of abstract policy issues in concrete human terms. He thought of the nation as being like a family, and the federal budget as being like a household budget. … An overspending nation, he argued, like an overspending family, was one 'on the road to bankruptcy'." (Cohen: 85).

It is thus important to note that despite common interpretations of Roosevelt's employment and public works agency expenditure policies as being influenced by Keynes's economics, to the contrary, these polices sought to restore faith in the ability of government to provide a safe and stable economic environment by avoiding the introduction of stronger interventionist alternatives; "expansive fiscal policies also were ruled out. … the New Deal remained committed to fiscal conservatism, the one orthodox economic idea still standing. Most university and think-tank economists who advised the Roosevelt administration worried that large federal deficits would undercut the dollar's value, reduce national savings, and raise consumer prices unduly. "… Roosevelt urged Congress "to pass the Economy Act to cut federal expenditures by $500 million, and permit him to reduce federal salaries and cut payments to veterans, stating that "too often in recent history, liberal governments have been wrecked on the rocks of loose fiscal policy. We must avoid this danger."" (Katz Nelson: 235)

Indeed the only way in which Roosevelt the candidate differed from Hoover was that the former considered "the urgent question of the day as the prompt balancing of the budget. When that is accomplished I propose to support adequate measures for relief of distress and unemployment" to which Roosevelt countered "If starvation and dire need of the part of any of our citizens make necessary the appropriation of additional funds which would keep the budget out of balance I shall not hesitate to tell the American people the full truth and ask them to authorize the expenditure of that amount." (May, 1981: 77). In the end, it was necessary to propose a politically popular bill to legalise 3.2 percent alcohol content beer to overcome the massive opposition to a bill that would cut spending in the face of rising unemployment.

The ambiguity with which he approached budget balancing is also present in the last-minute request to amend the Economy Act to provide $300 million for a program to send young men out to plant trees. His advisers viewed this as asking Congress to approve an internally inconsistent policy, whereas Roosevelt clearly did not. "Roosevelt's impulse of humanitarianism let him eventually to break down the old … belief that paupers somehow deserved privation and public calumny. Respectable self-reliant, able-bodied people found themselves poor, through no fault of their own, and with no independent means of altering their situation. This led Roosevelt's employment policies to a "disregard of the traditional distinction between public works and work relief to provide employment that would preserve the maximum the self-respect and pay a living wage." (May 77)

The commitment to a balanced fiscal position would eventually prove to be the issue that produced a second “critical point” in the operation of the New Deal and one of the most important lessons to be taken from the 1930s experience. We return to this critical juncture below.

The “Real” New Deal

Once faith and confidence in the banking system had been restored the New Deal could turn to the problems of restoring confidence in the production and investment decisions that would be required for recovery of output and employment. For Roosevelt this could only be achieved by first restoring confidence in the ability of government to provide conditions of economic certainty by introducing changes in the structure of the economic system which would convert uncertainty into risk.

“Facing crumpled market policies, New Deal leaders searched elsewhere for economic designs. They had no wish to build a socialism in which the national state would supplant private firms to become the central economic actor, and they certainly did not want to discard private property.” Thus refusing full state planning and corporatism, which were the measures taken by other governments that had successfully beaten the scourge of unemployment and depression required “an American version of these two features of public intervention, Tugwell explained, aimed ‘to repair disaster, imminent, pressing,’ by providing ‘coordinated administration and negotiation’ that could create ’a control to conserve and maintain our economic existence’ by acting ‘to eliminate the anarchy of the competitive system.”” (Katz Nelson: 235) Thus, while the measures to provide immediate reversal of expectations involved the various agencies dealing with short-term relief measures, the real focus of the New Deal was Title I of the National Industrial Recovery Act entitled “Industrial Recovery” which was to provide the structural changes in the operations of markets and the degree of government monitoring of capitalism that would make further policies unnecessary. The sign of the Blue Eagle was to provide the certainty in the soundness of the operations. If the market system was not self-adjusting, the government would create mechanisms and institutions that would provide the adjustment, and convert the uncertainty of free market depression into risk-based decisions that would produce recovery. The NRA was to provide the control of the corporate structure while the NLRB would provide the framework for labor.

“Speaking at his 1933. Inaugural, Roosevelt chastised "the rulers of the exchange of mankind's goods, for "having failed through their own stubbornness and their own incompetence." None had talked of the "unscrupulous moneychangers [school] stand indicted in the court of public opinion, rejected by the hearts and minds of men," or had identified the "generation of self-seekers" who pursued "the mad chase of evanescent profits." No other had called for "unifying relief activities" that "can be helped by national planning" and for federal role so assertive that the country's national government would be called on to supervise "all forms of transportation and of communications and other utilities which have a definitely public character."

But, as already noted, these employment creating relief and public works expenditure programs were considered as temporary, once the economic structure had been reformed they would no longer be necessary as the government supplied the self-adjustment mechanisms that the market could not. But, the center piece of the recovery measures, the NRA, was an administrative and effective disappointment and did not survive legal challenge. Even contemporary commentators saw difficulties in its implementation (see Beard and Smith, 1934 Ch. IV, and Robey, 1934, Ch. IX) This left the short- term expedients of the employment creation programs as represented in the Title II of the NIRA entitled “Public Works and Construction Projects” providing for the Federal Emergency Administration of Public Works which produced the Public Works Administration (PWA) as the major policy lever. However, even this measure had little immediate impact as the disbursement of allocated funds awaited the completion of the planning of public works projects.

As noted by May “it was originally expected that the PWA would provide an immediate lift to the spending stream, which the NRA with its dramatic restructuring of the traditional determinants of production and distribution, would then sustain. Neither expectation was realized, and the summer rally was followed by an autumn slump leading the President to improvise hastily the Civil Works Administration in November to help the unemployed through the winter of 1933-34” (May, 79)

The increasing reliance on short-term expenditure measures – the WPA was consigned to Harry Hopkins and assigned the role of a more rapid spending funds and in offering the maximum impact on employment. “Roosevelt’s choice of Hopkins to head WPA meant that the Ickes ideal of efficiency – providing the finest possible public monuments at the minimum costs—was being supplanted. The Hopkins ideal of efficiency – providing a maximum of employment and spending in a minimum amount of time – was gaining dominance.” (May: 82)

The Legacy of the Platform and the Economy Act

And this emphasis on spending as quickly as possible eventually overcame the reversals of the autumn of 1933 and produced a slow improvement in conditions, but which was accompanied by sustained increases in government debt and quickly ran into the resistance of those advisers that had backed the Economy

Act and the return to budget balance. This raised a dilemma for the Administration and the Treasury staff was given the task of completing “The seemingly contradictory task of explaining that even though past New Deal fiscal policy had been beneficial, future policy, to be equally beneficial, would have to move in the opposite direction.” . By the end of 1936 decisions were taken to produce a balance budget in fiscal 1938 with provisions for debt reduction in 1939. And the impact of these reductions brought the threat of downturn that would bring the economy back to the conditions of 1933. As the pressure accumulated Roosevelt was pushed by his Treasury Secretary Morgethau to modify his support for the continued pursuit of budget balance from one which considered the New Deal policies as having succeeded so well as to have raised incomes to the level at which the government’s fiscal position was in balance to one that argued that the balancing of the budget was the only remaining positive measure available to combat what soon appeared to be a return to recession by inducing business confidence and higher private business expenditures. In this respect the now common arguments of crowding out, as well as Ricardian Tax equivalence! were used to garner support for budget balance measures.

But, there were counter-arguments from two influential advisers. Harry Hopkins had noted early on to Roosevelt that “the problem of unemployment would never be solved by emergency measures. A year after the Social Security Act was passed, he wrote: “While we have a problem of emergency proportions at the moment … we are faced for an indefinite number of years with a situation which will require a permanent plan that cannot be carried on as an emergency matter. WE should face this frankly. Hopkins advised extending unemployment insurance legislation and “supplementing it with a broad program of public works as an established governmental activity.” (Hopkins, 1999, 189)

Marriner Eccles also was key in promoting the evolution from budget balance as an indication of stability and certainty to the government’s use of fiscal expenditures as a means of stability. Eccles coined the term “compensatory fiscal policy” (May: 155) as response to the impending recession and argued against traditional expenditure policies in terms that call to mind the “confidence fairy” of more modern times: “The Republican Party was wrecked by relying on wishful thinking that business would turn up, while at the same time pursuing policies that intensified depression. … The situation today is too serious for us to rely on wishful thinking.” (May: 117)

Eccles (along with his advisers at the Fed including Lauchlin Currie)[8] had been early to identify the downturn as being induced by the reversal in the government budget. In a memorandum to the President

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[8] May (146-7) also credits the support for more active fiscal policy based on Keynesian principles to An Economic Program for American Democracy, authored by a group of Harvard and Tufts economists elaborated in 1937 and

he notes among other things that paradoxically the initiation of the Social Security system had resulted in the collection of $2 billion in taxes while "no part of this was disbursed in benefits. Moreover, the taxes pulled potential buying power out of the pockets of the very people most likely to spend the money if it had been taxed away from them. … To sum up, in the absence of consumer purchasing power upon which the speculative growth of inventoried had been based, the inventories were dumped on the market in a drastic deflation, and the conventional pattern of a recession was re-enacted". (Eccles: 295).

The combined advice of Eccles and Hopkins led to a revision of New Deal policy that came to be called the "socio-economic policy' to replace the "social-financial policy" approach to social problems. It began with an attempt to compute what level of national income would bring the nation near to full employment. Only after the desirable level of national income was decided upon and the amount of government investment needed to achieve that level of income were determined could policy makers begin to decide what forms the expenditures should take. … Equally significant for long-term policy was the implication that the economy had moved into a period .. requiring a continuous, or at least recurrent government stimulus to insure full utilization of manpower and other resources. (May: 142).

"The emerging attitude towards reform was implicit in the economic philosophy Eccles had helped bring to dominance in the New Dealers. Morgenthau, representative of the earlier New Deal, asked, when economic crisis is threatened, "How can farmers be helped? How can jobs be found for workers? What can we do for railroads? Eccles, representative of an emerging definition of New Deal Economic Thought, asked "What level of national income will bring full employment?" (May: 158).

The result was that the New Deal discovered Functional Finance in the form of "Compensatory Fiscal Policy" on their own, well before the Keynesian Revolution.[9] But, the important point here is that they recognized that it was a policy that had to be sold to the American people and implemented through congressional legislation. While it differed in form and essence from the initial fiscal policy predilections, it met the essential condition that it provided an end to economic uncertainty and an economy in which the past was a good predictor of the future.[10]

published in 1939. However, Sandilands notes that at Harvard in January 1932 Currie, along with Ellsworth and White, had already provided support for more active policies in 1932 in a memorandum submitted to Hoover, and most probably was part of the advice he provided to Eccles. See Sandilands and Laidler 2002

[9] Although as Herb Stein (1969: 108-9) notes in his chapter on "The Struggle for the Soul of FDR, 1937-1939, Keynes wrote to FDR on at least two occasions exhorting support for Eccles and Hopkins' position on increased federal spending, but was largely ignored.

[10] Again, the point is not about whether the decision to reverse the budget balancing was the cause of the recovery, but about the political process in determination of economic policy. Romer (1992) provides supports

By Way of Conclusion

The response to the banking crisis of 1933 and the response to the more generalized financial crisis of 2008 produced very similar responses – providing capital to the banks that the banks did not want and did not recognize as being necessary to their operations. In the end, government imposed the recapitalization of the banks with government funds in both cases. The basic difference was that in the former period is was the RFC that provided the capital on the basis of government mandated funded whereas in the latter period it was the Federal Reserve until it believed that it required Congressional backing because it was bailing out banks that where outside its authority to regulate. This would have been the equivalent of the RFC, but took the form of TARP. The motivation of these measures was similar, in the sense that it was thought that once the banks were solvent that the system would self-adjust and recovery would follow.

This is primarily because the concern in the 1930s was the confidence of the public in the financial system, and the problem was to stem a classic bank run; in 2008 it was the confidence of the financial system in the financial system, a counterparty run. The fear was not in the general public holding deposits in the banks, which was quickly quelled by increasing the ceiling on deposit insurance. With the Fed taking over the quasi-governmental role played by the RFC in the 1930s, the confidence measures largely worked, but rather than taking place via recapitalizing of the banks, the Fed became the guarantor and residual buyer of the impaired assets of the financial institutions which, pace Lehman Brothers, survived. Unfortunately the meagre measures to support household balance sheets failed miserably, and the support of the private sector financial institutions did not support private sector lending, but the majority of the recapitalization of the banks went into excess bank reserves. While the New Deal recognized that additional measures beyond stabilisation of the banking system to support household incomes were necessary to recovery, in 2008 the belief, based on Bernanke's (2002) lesson from Milton Friedman, that expanding bank reserves "a outrance" would be sufficient to prevent the subsequent recession. Whether or not Friedman was right for the 1930s, it was clearly wrong for the structure of the financial system in the 2000s, as he was eventually forced to admit when he dumped the problem of bailing out banks into the lap of an unwilling Congress. The suggestion that the entire could have been avoided by the Treasury buying out every underwater sub-prime mortgage is compelling.

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against the dominant mainstream opinion that the New Deal more or less laid the groundwork for the natural recovery of the system. It is ironic that apparently Romer's estimates of the stimulus that would be required to produce recovery after the bailout of the financial system in 2008 were sharply reduced on political grounds.

But, finally, and most importantly was the lesson of the New Deal post-banking crisis response. Roosevelt's initial diagnosis of the Depression was in terms of the distribution of purchasing power; "No, our basic trouble was not an insufficiency of capital. It was an insufficient distribution of buying power coupled with an oversufficient speculation in production. While wages rose in many of our industries, they did not as a whole rise proportionately to the reward to capital, and at the same time the purchasing power of other great groups of our population was permitted to shrink. We accumulated such a superabundance of capital that our great bankers were Vying with each other, some of them employing questionable methods, in their efforts to lend this capital at home and abroad. I believe that we are at the threshold of a fundamental change in our popular economic thought, that in the future we are going to think less about the producer and more about the consumer. Do what we may have to do to inject life into our ailing economic order, we cannot make it endure for long unless we can bring about a wiser, more equitable distribution of the national income."

To remedy this problem the main area "which seems most important to me in the long run is the problem of controlling by adequate planning the creation and distribution of those products which our vast economic machine is capable of yielding. It is true that capital, whether public or private, is needed in the creation of new enterprise and that such capital gives employment. … Let us not confuse objectives with methods. Too many so-called leaders of the Nation fail to see the forest because of the trees. Too many of them fail to recognize the vital necessity of planning for definite objectives. True leadership calls for the setting forth of the objectives and the rallying of public opinion in support of these objectives. Do not confuse objectives with methods. When the Nation becomes substantially united in favor of planning the broad objectives of civilization, then true leadership must unite thought behind definite methods." [11]

In the recession starting in 1936 it became apparent that the idea of an equitable capitalist system through voluntary indicative planning by corporations was not providing the income and employment that was promised after the resolution of the banking crisis. The instrument to provide the restructuring and reorganization thus became government expenditure. But this required the rejection of the one basic premise of orthodox economic theory that had been preserved in the early New Deal: fiscal austerity. As a result, it represented the need to convince first the members of the Administration of the need for such

[11] As a corollary of planning "It is self-evident that we must either restore commodities to a level approximating their dollar value of several years ago or else that we must continue the destructive process of reducing, through defaults or through deliberate writing down, obligations assumed at a higher price level." The quotations come from a May 22 1932 speech on receiving an honorary degree at Oglethorpe University available at http://www.fdrlibrary.marist.edu/_resources/images/msf/msf00486.

policies, and then the need to convince the President, and then Congress and then the general public of the error of looking at the federal budget in the same way as a single family budget. Roosevelt was eventually convinced, the Congress was eventually convinced, and the general public was eventually convinced, of the need to accept government expenditure as a policy tool rather than a necessary but undesirable consequence of the short-term antic-cyclical employment measures of provide relief. The eventual outbreak of the war should have provided the confirmation of the validity of this approach, irrespective of Keynes eventually publication of a theoretical justification, since it represented, in Katz Nelson's terms, the only possible response to escape full-scale State planning under Communism and Corporatism under Fascism.

FDR clearly understood the challenges faced at the "critical point" provided by the crisis, and the opportunity it provided: "The country needs and, unless I mistake its temper, the country demands bold, persistent experimentation. It is common sense to take a method and try it: If it fails, admit it frankly and try another. But above all, try something. The millions who are in want will not stand by silently forever while the things to satisfy their needs are within easy reach. We need enthusiasm, imagination and the ability to face facts, even unpleasant ones, bravely. We need to correct, by drastic means if necessary, the faults in our economic system from which we now suffer."

Thus, if there is a lesson to be learned, it is that this response to crisis has to be experimental, it has to be sold to the public and to the legislators. The forces of budget balance recognized that they lost the battle for the soul of FDR, but have vowed to never lose the battle again. This is the lesson and the battle that has to be joined. In the response to the recent financial crisis it was never joined. Relief of the financial system, rather than relief of the family was presumed to be sufficient. We are still waiting "for business to turn up" on the basis of traditional policies and the massive accumulation of corporate profits to lead to an expansion in investment and growth at the productive potential of the economy.

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